



DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

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SIN: 512.01-00

Contact Person:  
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Identification Number:  
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Telephone Number:  
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Employer Identification Number: \*\*\*\*\*

Dear Sir or Madam:

We have considered your ruling request dated May 24, 2000. We have spoken with your representative on several occasions regarding your proposed transactions. Because you are unable to state your plans with specificity at this time, we cannot rule definitively on whether any of your proposed activities will generate unrelated business taxable income. However, we are happy to offer you some general information that may be helpful.

You state that you are exempt under section 501(c)(3) of the Internal Revenue Code and file Form 990 annually. You own the \*\*\*\*\* (\*\*), (100% stock ownership), a carpet cleaning and construction company. \*\*\* is a commercial corporation and files Form 1120 annually. You plan to accept contributions of building materials from \*\*\* and to use those materials in various business activities to generate funds for the support of three orphanages you operate in \*\*\*\*\* and various ministries in which you engage in the United States.

The tax on unrelated business income applies to all organizations exempt from tax under section 501(a) except certain U.S. instrumentalities. Unrelated business income is the income from a trade or business that is regularly carried on by an exempt organization and that is not substantially related to the performance by the organization of its exempt purpose or function other than the fact that it uses the profits from the activity to fund those exempt purposes. The term "trade or business" generally includes any activity carried on for the production of income from selling goods or performing services. Business activities are considered "regularly carried on" if they are engaged in frequently or continuously and are pursued in a manner similar to comparable commercial activities of nonexempt organizations. A business activity is "not substantially related" to an organization's exempt purpose unless it contributes importantly to the accomplishment as opposed simply to the funding of the organization's exempt purposes.

The determination of whether a certain activity generates unrelated business income must be made by considering all the facts and circumstances. Your letter presents numerous hypothetical situations in which you ask us to apply a facts and circumstances analysis to

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determine whether a particular activity would be considered an unrelated trade or business. We don't have sufficient facts about any one activity described in your letter to do this. However, an activity that is conducted only once or on a limited, irregular basis might not be considered unrelated trade or business. For instance, if \*\*\* or an individual donor made a donation of building supplies or a barn to you and you sold it, on a one time basis, it would, most likely, not be considered a trade or business and the income would not be taxable. The more often an activity is conducted, the more likely it will be considered a trade or business regularly carried on. Your hypothetical situations imply that the described activities will be of an ongoing nature rather than a one time deal and that they will be regularly carried on.

Some activities are excluded from the definition of unrelated trade or business even if the activity is a trade or business and it is regularly carried on. Two exclusions may apply to the activities that you are contemplating. First, the volunteer labor exception applies to a trade or business in which substantially all the work is performed for the organization without compensation. For example, a retail store staffed by unpaid volunteers who perform substantially all the work would not be taxed as unrelated trade or business income. The second exception, the donated merchandise exception, applies to a trade or business that consists of selling merchandise substantially all of which the organization receives as gifts or contributions. An example of this would be the operation of a thrift shop selling donated clothes and books. These exceptions are independent of each other. A business operated entirely by volunteer labor may purchase or manufacture inventory for sale, while a business selling only donated goods may hire a paid staff to conduct the business.

Thus, in Situation 1, \*\*\* might donate miscellaneous building parts to you on a regular basis. You could sell the parts "as is" and use the funds generated to further your exempt purposes. The donated merchandise exception would exclude revenue from this source from the tax on unrelated business income whether or not you paid a staff to conduct the business. If you use the material to manufacture a different product for sale, the donated merchandise exception would not apply. However, if the new products are produced and sold exclusively by volunteers, the revenue generated would be excluded from the tax on unrelated business income under the volunteer labor exception. Situation 2 is similar to Situation 1 except that the building parts are donated by the building's owner rather than \*\*\*. The donated merchandise exception and volunteer labor exception would operate in the same way. If you sell the items "as is," the donated merchandise exception applies. If you alter the property but the business is conducted by workers who receive no compensation, the volunteer labor exception applies.

In Situation 3, you indicate that individuals are willing to donate wooden barns to you. You would dismantle the barns and sell the beams. Whether the donated merchandise exception applies depends on all the facts and circumstances. Without further details, we are not able to determine whether the donated merchandise exception would apply if you dismantle the barns, transport and store the wood, and sell the wood as unfinished beams. The activity of taking down the barn and clearing the land is itself a business activity. The volunteer labor exception might apply if all the work is done by individuals who receive no compensation.

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Please be advised that this letter is advisory only and has no binding effect on the Service. The information provided here cannot be relied upon as a ruling on the matters discussed. Because we have not given you a definitive ruling upon which you can rely, we will return the user fee you submitted with your request. The processing of this matter may take several additional weeks. If you have any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Gerald V. Sack  
Manager, Exempt Organizations  
Technical Group 4